STOCKS TUMBLE ON RUMOR OF CRISIS

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Rumor of a Crisis Pull Down Stock Prices

In September, the rumor of a "November Financial Crisis" has spread to almost every sector of the domestic financial market, including stock and bond markets. The rumor has it that the current instability in the financial market will reach its peak in early November when investors with exposure to Daewoo bonds are allowed to retrieve 80% of funds from their trust accounts. Investors forecast that massive redemptions will then occur, pushing investment trust companies (ITCs), whose bond portfolio includes a slew of Daewoo bonds, to the brink of insolvency, which will in turn send interest rates soaring and stock prices plummeting. As the ITCs sell more and more bonds, they will incur increasing losses, which will lower the returns on their beneficiary certificates. That will, once again, speed up the general public's run to ITCs, some of which will end up insolvent. This sort of vicious circle of panic selling constitutes the rumored crisis scenario.

Seoul bourse showed a sound performance in the early September, actually. The Korea Stock Price Index (KOSPI) rose over 980 points at one time during September, helped by the expectation sentiments of the competitive advantages of local exporters through the rising yen against the dollar and soaring global semiconductor prices. However, the KOSPI tumbled down to 836.18 points on September 30 from 980.91 points on the 13th day of the month, as a rumor of the so-called "November Financial Crisis" was spreading over the local stock market. Foreign and domestic institutional investors, who once led the long-term Korean bullish market during the first half of this year, turned out to be net sellers. Only individual investors remained net buyers during the past month.

BMSF Will Calm the Local Bourse Down

In order to calm down the public's psychology and thus bring an order to the financial market captured by the rumor of "November Financial Crisis", the government announced to launch the "Bond Market Stabilization Fund (BMSF)," amounting to 20 trillion won worth, as a financial market stabilization measure. After it launched the BMSF, stock market seemed to hold its free-fall and interest rates seemed to fall significantly. But many investors do not expect the BMSF to bring a fundamental change to the stock market; they instead forecast that the market will not continue to react to the BMSF until new fund "really" flows into the market and thus expand the demand for stocks. While the BMSF is supposed to be raised up to 20 trillion won, the bond-type investment trusts which are sources of instability are totalling 180 trillion won, nine times the amount of the fund. The oversupply of bonds is expected to negatively affect the domestic interest rates as well as stock prices, particularly at a time when investment trust companies are scheduled to proceed restructuring. While the government is measuring the potential risks, most investors are waiting for a second round of market stabilization measures of stronger impact. VIP